$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

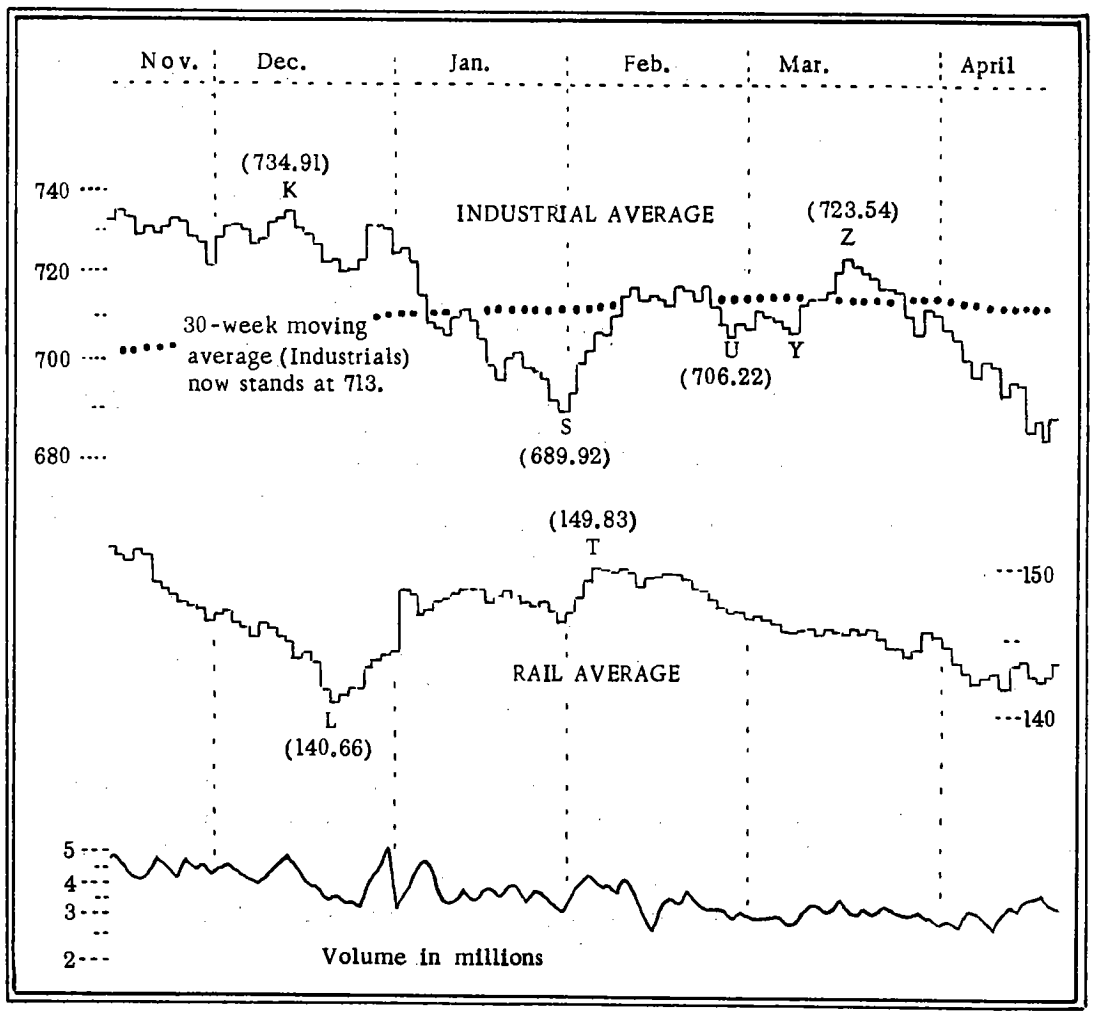
RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

Registered with the Securities and Exchange Commission

THE MARKET Last week's news underscored two facts which were already well known to most observers: (1) Public relations in the steel industry is unbelievably bad; (2) President Kennedy stands ready to denounce business and business leaders in public (in a manner not seen since the Roosevelt days of the early thirties). As for the effect of last week's shenanigans on the market -- technically, the market was in trouble anyway. The steel price increase brought in a spurt of odd-lot (public) buying and gave professionals a chance to unload stock; the Kennedy tirade gave the market the excuse it needed to tumble.

On April 12 the Industrial Average plunged over nine points to 685.67. This took the senior Average below its January low of 689.92 -- to the lowest level since July, 1961. Subscribers are aware (see last Letter) of the technical importance of the April 12 drop below the 689.92 level. This penetration means that for the first time since May, 1961, the major series of divergences between the Industrial Average and the advance-decline ratio has been eliminated.

Of particular significance is the fact that Rails touched their low point on April 9 at 141.80, but this low was more than a point above their December, 1961 low of 140.66 (L -- see chart). Moreover, April 12's broad weakness found Rails still holding above their December low. Thus, the "lowly carriers" have refused (so far) to confirm the penetration of Industrials. Subscribers might remember that many important reversals have resulted from a persistent refusal of one Average to confirm the penetration of the other (the last example of this occurred at the October, 1960 lows). In the present situation, the longer Rails hold above their December low of 140.66, the better the odds will be for an important change in market direction (to the upside).



Daily volume on the decline (so far) has held consistently below the 3.4 million share mark. This suggests that up to this point, the decline has resulted more from declining bids and diminishing buying power than

from rising selling pressure. It is worth noting, however, that most bottom areas are accompanied by either (1) a one or two day flare in downside volume (the" selling climax" so dear to the hearts of analysts), or (2) a definite "test" of the final lows. On such a test, one or both Averages will hold above the extreme lows and volume will drop sharply. This is the performance which was seen at the October, 1960 lows.

The number of daily new lows can also be helpful in calling the turn. Often new lows will expand to a peak as the market drops. If that peak is not surpassed on the next decline (even though one or the other Average drops to new lows), this often signals the bottom.

When watching for indications of a bottom, some are apt to be impatient while others are apt to be overly cautious (and demand perfection). The market is in the over-sold area now, and the persistent refusal by Rails to break 140.66 suggests that a turn could come at any time. The trend of odd-lots is the only thing that bothers me at this time.

Up to this writing, the trend of odd-lot trading has been toward increased buying as the market works lower. History shows that when a final bottom is struck odd-lot transactions usually will have been moving towards less buying (or actual selling) for a period of four or five days. Thus, odd-lot transactions do not yet suggest the bottom. On April 13 odd-lot shorts climbed to 5,000 shares, the first "over 5,000" figure of the entire decline. The odds, however, favor a few such days before the final bottom is reached (the January decline ended with a day of almost 8,000 odd-lot shorts).

CONCLUSION: I put the odds at 50-50 that the lows were seen by Industrials on April 16 at 684.06. I put the odds at two-to-one that the lows were seen by Rails on April 9 at 141.80. I put the odds at three-to-one that if there is another decline -- it will be the last one. My own inclination is to enter the market carefully now -- and to "average up" if the advance which began on April 17 shows signs of gaining momentum. At any rate, I believe the downside risk is now limited. Positions should be taken with care -- and increased as and if the market "gathers steam" in the days ahead.

THEORY Many letters have arrived asking for more information on the prospects of a potential reversal and advance as discussed in the last Letter. That there will be an advance requires no great stretch of imagination from this point. Indeed, we are now in much the same situation as the old farmer who when asked by an Eastern dude, "Do you think it will rain?", scratched his head and replied, "Well, it always has". Following declines the market has always rallied. The real question is therefore -- how far and how long an advance?

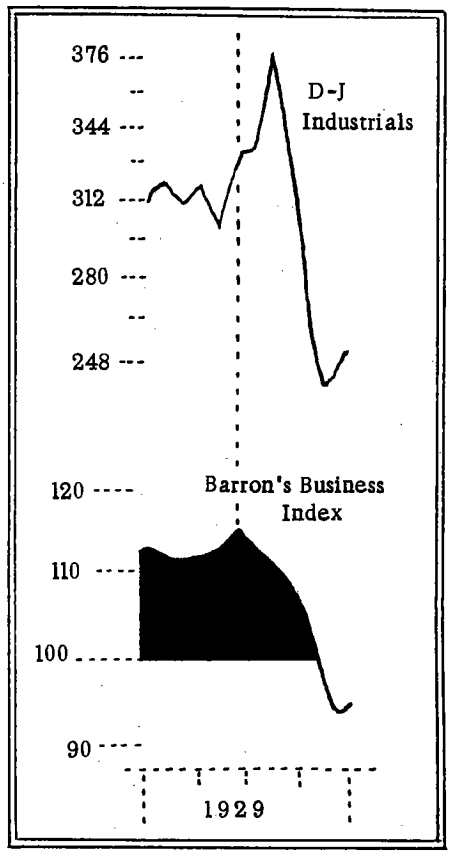
In Letter 173 I discussed the various upward swings of the majority of issues (i.e., the advance-decline ratio) since 1949. In that Letter I noted that an excellent gauge of the strength of a market advance is the length of time during which the majority of issues can continue in a rising trend.

In 1949 the market started up and the A-D ratio (which measures the direction of the majority of issues on the N.Y. Stock Exchange) continued in a rising trend for 45 months. Following the 1953 reaction, the A-D ratio turned up again in a rise which was to last 31 months. The 1957 reaction followed, and the A-D ratio's 1957-59 climb lasted 15 months. Again the market ran into trouble (1960), followed by a 7 month rise to May, 1961. Thus, it can be seen that the tendency of each successive rise has been towards shorter and shorter swings in the majority of issues. I might add that the tendency on each rise has been towards more explosive swings.

Now the following is strictly theoretical, but it does not lack a basis in logic: I believe that there is a good chance that if we get the rise alluded to in the last Letter -- that rise could well be the most violent of the whole series -- and the shortest. In fact, it would not surprise me to see a sharp climb and a "top" on the A-D ratio within a matter of four months or less!

Obviously, if the above comes to pass, it will be extremely important (1) to buy stocks as near to the bottom as possible; (2) to "clean out" when the move appears to be getting dangerous. Those who insist on holding for "capital gains only" (over six months) may well run the risk of "riding them over the top". I suggest that readers keep an open mind -- we have been patient for over a year and it has paid to be patient. If the rise materializes, I predict that it will also pay to keep tight reins on our natural human tendency towards "greed" (and this includes the writer as well).

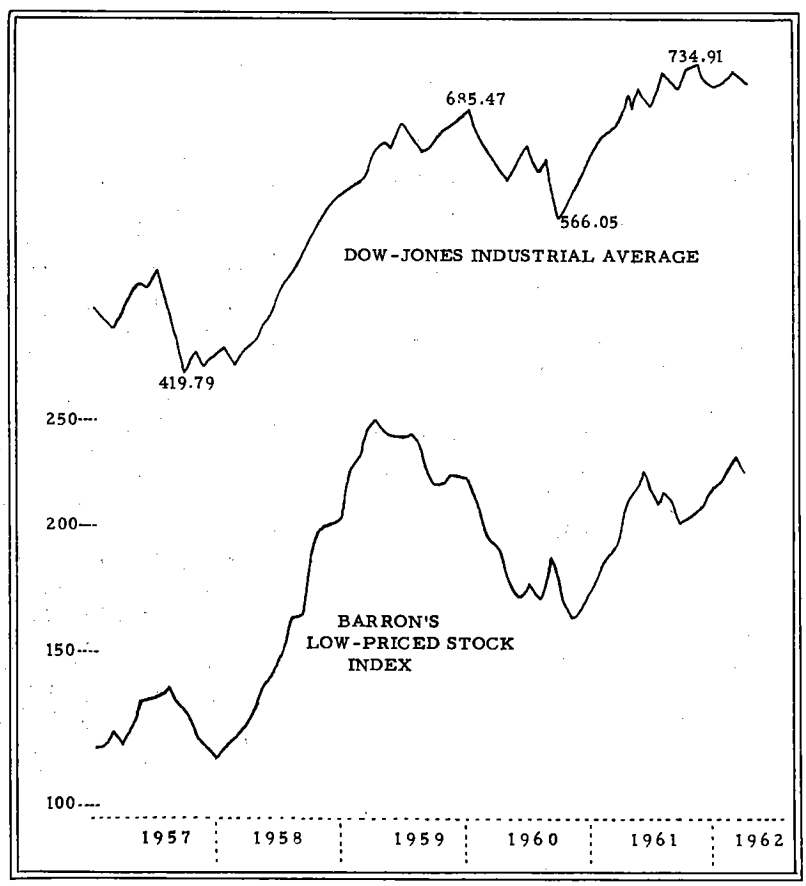
A second item now bears discussing. If we enter the advance discussed in Letter 176, many businessmen will be convinced that it will signal "a boom in the economy". I am not of that opinion. The type of short, violent market rise which I have been writing about is usually not accompanied by a comparable expansion in business. These rises seem to materialize almost in the manner of a "technical-fundamental double-cross". In proof, I have included a chart of Barron's Business Index and the Industrial Average during the "blow-off" year 1929. Note the insignificant rise in Barron's Index early in the year; note also, that business "topped" in June, 1929 (!), despite the fact that the Industrials went wild during the third quarter of that year. It would not surprise me to see something on the same order occur again. In other words, I would view a market "blow-off" here as an opportunity for businessmen to "batten the hatches", not as a signal for the inauguration of expansion programs. We are now very, very late in the cycle. Stocks can be parted with in an hour -- but it takes many months to pull in one's "business horns".



LOW-PRICED STOCKS One of the strange phenomenons of the recent market has been the action of "the cats-and-dogs". Barron's Low-Priced Stock Index recorded its high in the first quarter of 1959 at a price of 250. During the long 1960 decline this Index dropped to the 160 area. In former bull markets, a comparable collapse in low-priced stocks has been a sure signal of the end. Not so in 1960.

Rallying from its 1960 low, the L-P Index touched a peak of 226 in June, 1961. A minor decline followed (see chart), but by early March, 1962, the L-P Index had risen to 239 -- just eleven points under its 1959 high. Last week, in the face of a sloppy market, the L-P Index closed at 219. This was a good performance under the circumstances.

What is the significance of the unprecedented recovery of the L-P Stock Index? In my opinion, the strength suggests the possibility that the next upward market swing could produce new highs on many speculative issues and in the L-P Index. This statement also fits in with the theory of a speculative rise as discussed in the last Letter.

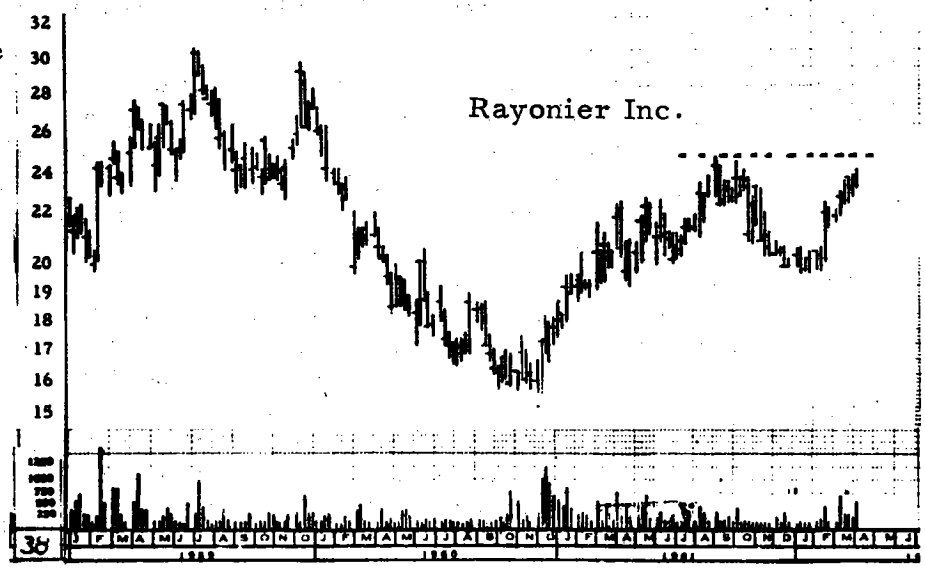


Of the twenty stocks that make up Barron's L-P Stock Index, fourteen are listed on the "Big Board" and six on the American Exchange. Of the fourteen Big Board issues, the following six remain technically bullish and may be purchased on a market turn (figures in parentheses after each stock are point which, if touched, will turn stock from bullish to bearish): Avco (22)....Baldwin-Lima (14)....Coty International (5)....Cudahy Packing (15 1/2)....Libby McNeill (12).... So. Amer. Gold & Platinum (6 1/2). In addition, Coty (not Coty International) is a low-priced issue which will give a strong "buy signal" on a rise to 22 .

STOCKS Of our 56 "key" stocks, only 6 are now above their 10-week moving average. These are Alcoa, American Can, Chadbourn-Gotham, Owens-Illinois Glass, Proctor & Gamble.

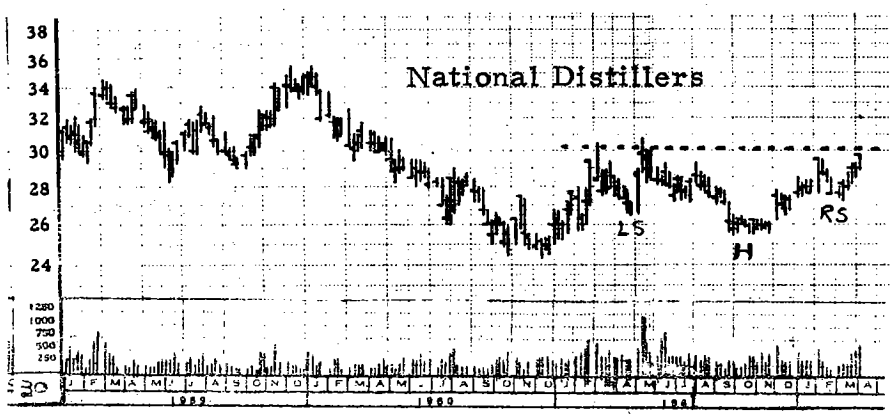
Up to this writing, the Rail action has been superb. The chart on page 1 gives graphic

testimony to the carriers' stubborn resistence on the downside. Such action, if it continues, suggests that Rails could well lead at the turn. A strong Rail "package" might include Southern Pacific, Union Pacific, Louisville Nashville, Missouri Pacific "A", Western Pacific. Among more speculative Rails, Chicago Rock Island, Denver Rio Grande, St. Louis San Francisco. I would not discount the Rails for a substantial (and even surprising) percentage move if the Average continues to hold above 140.66!



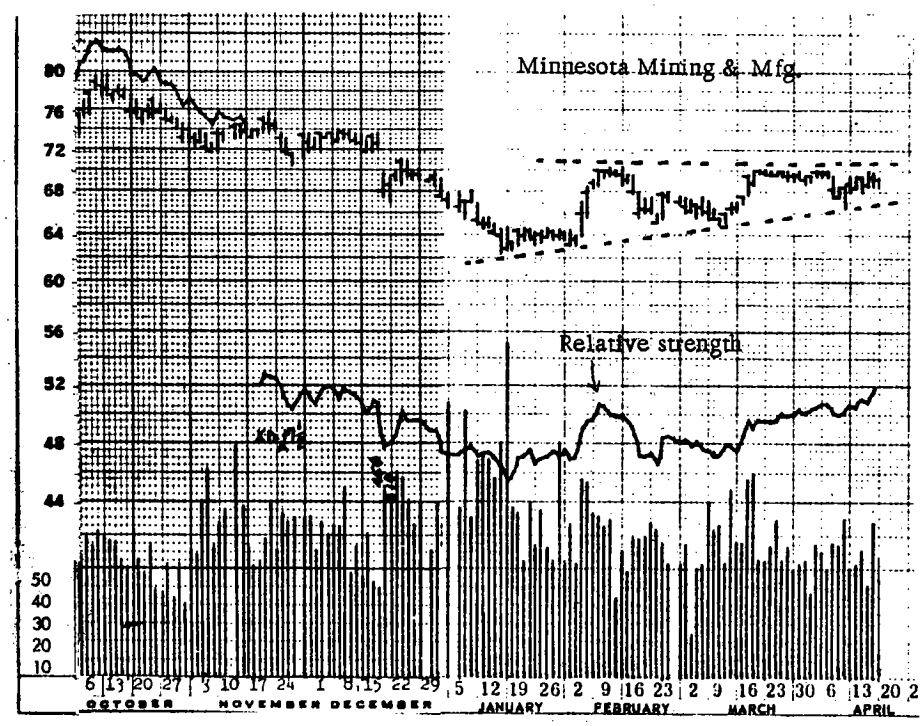
Strongest groups at this time are containers (including glass), liquors and utilities.

National Distillers was recommended in Letter 170, and the stock continues to look strong. The weekly chart shows an inverse "head-and-shoulders" pattern. A clear "buy signal" will be given at 31, but I believe the stock can be bought now.



Back in Letter 154 I drew attention to the strength in Rayonier. The RNR reacted around the turn of the year, but since then it has come back for a try at the 1961 high. A buy signal will be given by RNR at 25.

Minnesota Mining has dropped well below its high of 88. However, the stock hit bottom early in 1962, and since then it has been tracing out an ascending triangle. MMM will give a buy signal at 71.



LATE NOTE: Yesterday (Tuesday, Apr. 17) saw a strong rally in which Rails traced out the first ascending zig-zag and Industrial climbed over 4 points. Today (Wednesday Apr. 18) Industrials have opened higher by another 4 points. This is pretty violent action, but it does not preclude a "testing" of the recent lows. If volume dries up on such a test and one or both Averages hold above the lows -- buy them. The thoughts expressed in the "conclusion" section on page 2 still hold.

Charts courtesy of Traders Research P.O. Box 2644, St. Louis 16, Mo.

Written 11:30 A.M. Wednesday April 18.